Bogdan Kowalewicz
Office of Gas and Electricity Markets
9 Millbank
London
SW1

Shell Gas Direct Ltd
1-3 The Strand
London
Tel +44 (0) 20 7257 0132
Email: amrik.bal@shell.com

22 May 2009

Dear Bogdan

Proposed disposal of part of NTS for Carbon Capture and Storage: Ofgem consultation document

Thank you for the opportunity to respond to the issues raised in this consultation document. Answers to the specific questions in the document are contained in Appendix 1 and are offered on behalf of Shell Energy Europe BV (which, through Shell Gas Direct Ltd, is a licenced GB gas shipper and supplier) and Shell UK. In addition to these answers, we would also draw your attention to the following general comments.

The document contains a number of comments regarding the potential impact of the proposal on gas security of supply. Given that National Grid is in receipt of data and information from all market participants through, for example the TBE and Ten Year Statement processes, along with an experienced understanding of the operational dynamics of the NTS, we consider that any judgement in this regard is best left to the regulatory authorities.

However, other things being equal, eg. security of supply, the proposals put forward by National Grid appear to have the potential to make an important contribution to the realisation of one of number of potential Carbon Capture and Storage (CCS) projects and therefore warrant careful consideration.

While there is no silver bullet to eradicate the threat of global warming, we believe that achieving the necessary cuts in carbon dioxide emissions, whilst energy use continues to grow, won't be possible without the widespread CCS deployment. However, this technology is in its infancy and the cost of first-generation major industrial facilities with CCS is too high for industry to bear alone, so ensuring it is deployed with the necessary urgency will require transitional financial support to make it commercially attractive whilst costs are progressively brought down through 'learning by doing'. We therefore welcome the competition for Government support for a CCS demonstration project in the UK, and the recent announcement of measures to provide for up to a further three demonstration projects over the coming years. The proposals put forward by National Grid have the potential to make an important contribution to the realisation of one of these projects and therefore warrant careful consideration.

I trust that you find our comments helpful. Please do not hesitate to contact me should you have any questions or require further clarification.

Yours sincerely,

Amrik Bal
UK Regulatory Affairs Manager
Shell Energy Europe BV

Appendix 1

CHAPTER 2: Proposal to dispose of assets for CO_2 transportation

Question 1: Do you think this proposal is a good idea in principle?

The reduction of CO_2 to meet climate change commitments is and will remain an increasingly important plank of energy policy in its broadest sense. In that context, what is being proposed could be expected to help meet such aims and in principle, therefore, appears to be a good idea.

However, what should not be forgotten is that the assets in question are nearly fully depreciated for price control purposes. As such, it would be logical to expect consumers to be the main beneficiaries of this proposal. The flip-side of this view - and with respect to the various remuneration options outlined in the document - is that NGG should pay:

- A market rate for the assets. This rate could be determined via an auction or tender; or
- Any revenue sharing mechanism should see the majority of benefits flowing to consumers.

An important issue with either of the above is that the benefits to consumers should be transparent and demonstrable.

Question 2: In the event that a feeder section is removed, existing compressors may be required to work harder to transport the same volumes of gas through fewer pipes. It is proposed to capture these additional compressor fuel costs and to introduce a capped volume for these additional fuel costs, based on pre-disposal levels, over which the new CO_2 transportation business would bear the costs and make payment to NGG. What is your view of this proposed treatment of these additional compressor fuel costs?

Clearly, an inappropriate way of allocating these costs could result in a cross-subsidy from shippers (and ultimately consumers) to the new transportation business. This aspect of the proposal, at least in principle, seems a pragmatic suggestion to help guard against such an outcome.

An issue that Ofgem may wish to address, however, is the potential impact of pushing the same volumes of gas through fewer pipes. In other words, would the state of the remaining assets, ie. pipelines and compressors, deteriorate faster?

CHAPTER 3: Regulatory issues

Question 1: Do you agree with our view of the regulatory issues of the proposed asset disposal?

We note that there is no mention of any regulatory involvement/approval of any sort from the HSE. Perhaps this issue could be cleared-up?

Question 2: Do you agree with the projected forecast flows at St. Fergus?

As indicated in our covering letter, it is not immediately obvious how an individual shipper would be able to make an informed comment on the analysis. Others, ie. DECC, Ofgem and NGG will have a more complete picture of data underpinning supply & demand forecasts and the operational performance of the NTS.

We would, however, suggest that the regulatory authorities may wish to arrange for an independent analysis of NGG's assertions and conclusions.

Question 3: Are there other flow forecasts or scenarios which should be taken into account?

None that we can identify at present.

Question 4: What is your view of the indicated capability at St. Fergus with the feeder removed, with and without additional compression?

A very general observation is to welcome the fact that NGG feels it would be able to guarantee the current baseline figure of 154mcm. There are a number of aspects of the entry capacity regime that seem to be in a constant state of flux and we would not want more uncertainty wrt baseline levels over and above that already caused by both the transfer and trade and proposed substitution mechanisms.

Other than the above, it is difficult to comment further in any meaningful manner without a detailed description of how NGG arrived at the various figures, ie. its system modelling methodology. Even with the availability of greater detail, it is still not clear on which basis shippers would have the expertise and knowledge to use it and contradict NGG.

This should not be taken as an unhelpful comment. Rather, it should be viewed as recognition of the fact we do not have the requisite system modelling skills, hence our suggestion that an independent audit of NGG's work is required.

Question 5: What is your view of the projected buyback costs which have been identified?

On the basis that baseline capacity levels can continue to be met at St Fergus, it is not clear on what basis there would be an increase in buybacks.

Question 6: Are there any other issues that you believe are relevant?

One issue is this proposal's potential impact on the incentives for the maintenance of baseline capacity levels at St Fergus? Presumably, the lower the baseline level, the lower the buyback exposure?

Therefore, unless Ofgem is absolutely convinced of NGG's assessment of the proposal's likely impact on buyback risk, a danger exists that a request for a reduction in baseline levels in the next transmission price control may in fact be related to this proposal. A similar concern may exist with a substitution methodology as this could potentially be skewed towards incentivising moving capacity away from St Fergus.

Question 7: What is your view of the proposed disposal of these assets?

Please refer to our answer to question 1.

CHAPTER 4: Valuation of assets

Question 1: Do you agree with the possible ranges of valuations for the assets which have been identified?

Question 2: Do you agree with the assumptions which underpin the asset valuations?

Question 3: Is there an alternative method of asset valuation which should be considered?

The range of options used to value the assets seems reasonable. As for the values themselves, clearly, it is in Grid's interests for a low asset valuation, primarily because this will make the proposed CCS project more profitable. However, the valuation has to be the 'correct one' and for two reasons:

- Too low a valuation could reduce the amount of money going back to consumers under a lump sum payment; and

- Too low a valuation may in effect amount to an implicit cross-subsidy to Grid, possibly helping distort competition in this particular market. The degree to which this is a real issue will depend on the likelihood of competing projects or other methods of transportation.

The extent to which the valuation is a correct one is ultimately a decision and judgement call for Ofgem. In that context, we welcome the reference in paragraph 4.20 regarding Ofgem's primary duty to protect comsumers and fair value.

On a related note, it is not clear why any subsequent valuation should not be tested in the marketplace. For example, why not hold an auction, logically using the valuation as proxy reserve price? Grid would, of course, be free to participate and such a process would reveal the true market value of the infrastructure.

The above comments are merely intended to help ensure that consumers are ultimately recompensed appropriately. Our comments are intended to deter Grid from acting or being rewarded for acting in an innovative manner.

CHAPTER 5: Commercial options

Question 1: Do you consider that the opportunity to potentially share in the benefits of CCS using ex NTS assets represents an appropriate balance of risk and reward?

In short, yes. However, the more complicated and dependent on future events the basis on which reward and risk is calculated, the more difficult it becomes for consumers to determine that they are being rewarded appropriately.

Moreover, given that Grid appears to have expressed a preference for a low asset value, it is difficult to determine whether there is any appreciable degree of risk for NGG.

Question 2: What is your view of a lump sum payment, in the event that consent is granted for disposal?

Given what we say in response to Q1, we consider that the lump sum option, simplistic though it may be, represents the most transparent way of rewarding customers and protecting them from any increase in buyback costs.

Question 3: What is your view of a participatory royalty arrangement, in the event that consent is granted for disposal?

This option is our least preferred option given that it would result in exposure to buyback costs.

Question 4: Are there other risks / benefits which should be taken into account?

None that we can identify at present.